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A. P. RICHARDSON, *Editor*

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EDITORIAL

The Insull Case

With dramatic suddenness the first chapter of the celebrated case against Samuel Insull and others came to an end, as the jury after two hours' deliberation brought in a verdict of not guilty. The specific charge under which this first case proceeded was one of conspiracy and using the mails to defraud. There are many interesting lessons to be learned from the case and one of them, at least, is of the utmost importance to professional accountants. In general the verdict of not guilty seems to indicate that the jury may have been swayed by two major considerations, in addition to that which has been openly reported. It is said that the verdict was largely attributable to the appealing defense presented by the chief defendant, but it seems to us that other equally cogent reasons induced the jury to reach its conclusion with such astonishing rapidity. In the first place, it seems that the government through its very able prosecutors overbid its hand and, in alleging conspiracy from the inception of the Insull companies, went far beyond all reasonable bounds and thereby weakened the entire argument against the defendants. We are not concerned at the moment with the moral responsibility for the collapse of the great group of public-utility companies with which the name of Insull has been inseparably associated. Probably it is safe to say that what was done in that case did not differ greatly from what was done in countless other cases. Reprehensible as much of the conduct of the companies may have been, there would certainly have been no hue and cry of ven-

geance had the prosperity of the companies not been destroyed by the collapse of values in 1929. We do not mean to express approval of what was done, but merely in fairness to all to point out that it was failure which discovered bad practice. No inherent badness of the practice itself led to attack upon it.

**Sympathy with the
Under Dog**

The second general consideration which must have impressed itself upon the jurors was the position which all corporations great and small, good and bad, now occupy in our current scheme of destructive reformation. There have been so much tumult and shouting, so much misrepresentation and so much lying about business, that people are becoming a little weary of the campaign of calumny. Heaven knows there has been enough unworthy custom in the transaction of business, but that is not to admit that everything with which the words corporation and company are remotely concerned must of itself be wholly evil. The ordinary man is a reasonable creature and is not to be deceived forever by loud words oft repeated. Here in America we like to think that the ordinary man is also a champion of the under dog. And so it seems that as the chase quickened and every form of profit-seeking activity became a quarry, the spectators tired of the pastime and began to wonder if perhaps there might not still be some little goodness hidden away somewhere under the skin of American business. From such a vague surmise there has grown more and more impatience with outrageous prosecution of business merely because it was business. Therefore, while the jurors may not have mentioned the matter in the jury room, it seems just to suppose that in the mind of each one of them there may have been, perhaps subconsciously, a feeling of distaste and a willingness to give business a chance to carry on.

**Treatment of Stock
Dividends**

The point which is of peculiar and enduring interest to accountants in the whole Insull case is, however, one of technique. The case dealt largely with the pyramiding of investments and the inter-company payment of stock dividends, which were taken into the respective accounts at the market prices on the dates of declaration. The government sought to prove, and perhaps succeeded, that the market was artificially

stimulated, and that therefore market prices for a share of stock were not indicative of any lasting value. But here again, we think, the government may have missed the vital factor. Whether the market were "rigged" or not, it was not good accounting practice to enter among the assets of any company stock dividends which were retained in the portfolio of the recipient. Probably ninety-five per cent. of practising accountants agree with the decision of the supreme court of the United States in the case of *Eisner versus Macomber*. Even accountants who may have felt that there was good logic in the theory that a receipt which could be sold for cash might be regarded as income have now for the most part changed their opinions and are in favor of taking nothing as income which does not represent a closed transaction. Admitting all this there is, however, another side of the question which has been too much ignored.

A Dissenting Opinion Recalled To refresh the memory of readers, let us recall that the act of 1916 treated a stock dividend as income "to the amount of its cash value" and that the decision in *Eisner versus Macomber* was not a unanimous finding of the supreme court but was the subject of dissent by four justices, the maximum possible minority in a court of nine. The dissenting justices were Brandeis, Clarke, Holmes and Day, all of them men whose opinion is worthy of respect. These dissenting justices held that the 16th amendment to the constitution entitled congress to assume "in a sense most obvious to the common understanding at the time of its adoption" that the tax upon stock dividends as income was justified by the amendment. Justice Brandeis, with the concurrence of Justice Clarke, concluded his dissenting opinion in part as follows:

"If stock dividends representing profits are held exempt from taxation under the 16th amendment, the owners of the most successful businesses in America will, as the facts in this case illustrate, be able to escape taxation on a large part of what is actually their income. So far as their profits are represented by stock received as dividends they will pay these taxes not upon their income but only upon their income of their income. That such a result was intended by the people of the United States when adopting the 16th amendment is inconceivable. Our sole duty is to ascertain their intent as therein expressed. In terse comprehensive language befitting the constitution

they empowered congress, 'to lay and collect taxes on incomes from whatever source derived.' They intended to include thereby everything which by reasonable understanding can fairly be regarded as income. That stock dividends representing profits are so regarded not only by the plain people but by investors and financiers, and by most of the courts of the country, is shown beyond peradventure by their acts and by their utterances. It seems to me clear, therefore, that congress possesses the power which it exercised to make dividends, representing profits, taxable as income, whether the medium in which the dividend is paid be cash or stock, and that it may define, as it has done, what dividends representing profits shall be deemed income. It surely is not clear that the enactment exceeds the power granted by the 16th amendment."

**An Excuse but Not
Justification**

We find, therefore, that congress in its interpretation of the 16th amendment felt that it had a right to levy a tax upon stock dividends as income and that four justices of the supreme court agreed with congress that the taxation of stock dividends under the revenue act of September 8, 1916, was in conformity with the purposes of the so-called income-tax amendment. In view of these facts, it seems somewhat fantastic to attempt to classify as a crime the treatment of stock dividends as income to a corporation. As we have said, from the point of view of the accountant, there is nothing to be said in favor of the treatment adopted. It violates the principles of technique and sound economy; but those corporation officers and advisors who may have been induced to approve or at least to tolerate the inclusion of stock dividends as income can not fairly be accused of crime for doing what congress and the maximum minority of the supreme court held to be right. The most serious charge that could be laid at the door of those who favored such a classification of stock dividends would be an allegation of bad judgment and of lack of scientific knowledge. Had there been no act of congress supporting the theory of stock dividends as income, and had there been no minority dissenting in the supreme court when the case was under consideration, it might be possible to justify an accusation of criminal intent, but surely there can be no justice in imputing a crime to an individual officer who does what the majority of congress and a powerful minority of the highest court authorized. We believe, therefore, that the charge against Insull and his co-defendants, at least so far as the treatment of stock dividends was

concerned, was not supportable in law or reason, and it is satisfactory to know that a jury of twelve ordinary citizens threw out of court the charges which depended largely upon this one question of the classification of stock dividends.

**Probable Effects of
Decision**

What we have written with reference to the inequity of the charges against the defendants in the Insull case is based upon the principles of fair play, and we trust that it will not be construed as any attempt to approve the practice which was followed by the Insull corporations. In other words, to take into the accounts stock dividends as income was not a crime, but it was certainly bad accounting practice. The tragic break in market values of all securities demonstrated incontestably the fallacy of the theory upon which a stock dividend may be taken into the accounts as income. It may have no value whatever. Perhaps one of the few good results of the depression will be the final settlement of this controversial question. It is certain that the unwisdom of regarding a split-up of stock as productive of profit must have been finally demonstrated with the experiences of the last five years. Most accountants have long understood the true nature of stock dividends and have insisted that their clients regard them in their true light. At times there have been acrimonious differences between accountants and clients on this subject, and many officers of companies have felt that the accountants were needlessly scrupulous. What has happened in the Insull case, and in many others as well, will hereafter afford a sufficient argument against the misuse of stock dividends in financial statements, and the position of the accountant will be stronger than ever. In a word, then, we rejoice that the allegation of crime so far as it was supposed to lie in the mishandling of stock dividends was repudiated, and we rejoice even more that the accounting profession will be upheld in its attempt to raise to the highest level the accuracy and intelligibility of accounts.

**Arbitrary Reduction of
Fees**

The daily papers of November 15th contained reports of certain recommendations filed by the referee in bankruptcy in the Paramount-Publix bankruptcy proceedings. The referee recommended that allowances aggregating \$362,580

be made to lawyers and accountants for services rendered during the period beginning June, 1933, when the Paramount-Publix corporation was in the hands of equity receivers. The referee, sitting as a special master, had received petitions for allowances totalling \$720,000. These were reduced by his recommendations on the average about one half. We are particularly interested in the recommendations of the referee relative to the claims of accountants. In one case a fee of \$21,870 was reduced to \$10,000, and various smaller fees were cut in like proportion. These substantial reductions in fees were not apparently based upon any theory that the services of lawyers and accountants had been unsatisfactory. Indeed, the referee specifically stated that trustees, lawyers and accountants had devoted "long and careful attention" to the bankruptcy. Of course, the recommendations of the referee are not necessarily final, as to be effective they must be approved by the United States district court; but a highly important question is raised by this attempt to reduce fees of professional men. It seems that the lawyers and accountants in this case are not on exactly the same footing. It is understood that in this sort of work the fees for accounting service often are arranged in advance and the work is undertaken on the understanding that the fees will be paid in full. It seems, therefore, that there can be no excuse for an arbitrary breach of what is, in effect, a contract. If it had been alleged in the Paramount case that the fees were exorbitant, there might be some justification of an effort to obtain consent to a reduction; but apparently there was no thought of anything of the kind until the matter came before the referee. The duty of a referee in bankruptcy, as we see it, is to protect in every proper way the bankrupt concern and its creditors. There is an equal duty to both parties. We fail to understand, therefore, how the referee could advocate a sacrifice of the interests of the professional men who were creditors. As a matter of fact, the actual prime cost of the services rendered by accountants must have been much more than the amount recommended by the referee. It is rare, in the experience of accountants, to receive a fee double the amount of salaries and overhead; consequently the recommendation of the referee in this case, if approved, would involve an actual out-of-pocket loss to the accountants. There is no reason whatever why they should be expected to participate in the losses of the company. Every one knows that lawyers and other professional

men often demand fees which seem ridiculously high, but, of all the professions, accountancy is the one whose fees generally speaking are based upon actual cost with only a modest allowance for profit. There is all the less justice, therefore, in an arbitrary and destructive recommendation that fees be halved.

The Problem of Seasonal Business The financial statement of General Motors Corporation dated September, 1934, and distributed to stock-holders contained a letter from the president, Alfred P. Sloane, which will be read with close attention by accountants. Speaking of the seasonal character of the automobile business, Mr. Sloane said:

“The automotive industry, in common with many other industries, has a highly seasonal consumer demand. Normally, approximately 60% of the industry's yearly output is sold to the consumer in the first six months. Consumer sales in the two months of November and December are approximately 7.5% of the total for the year, as against 24% for the two months of April and May. Such an unbalanced situation throws a burden upon the whole production machine. Additional workers are required for the period of the peak season, with but limited opportunity for employment during the balance of the year. Longer hours are essential for the whole working force in the peak season, to offset the necessity of short hours in the season when the merchandise can not be sold except in greatly reduced quantity. This general situation has been intensified to the detriment of the wage earner and to the national economy in general by the code restrictions incident to the program of national recovery.

“While it is recognized that the ‘selling of straw hats in the winter time’ is bound to be of limited success, under any circumstances or conditions, nevertheless, the corporation is determined to do what it can in the spirit of helpfulness and coöperation, in the interest of its workers, whom it recognizes as vital contributors to the success of its business.”

Common Interests of Business and Accountancy Here is another striking commentary upon the difficulties encountered by all businesses which are affected by the rotation of the seasons. Accountants for many years have been advocating that business adopt its natural fiscal year; and at times there has been a disposition on the part of legislators and some business men to regard the efforts

of accountants to spread their work over the whole year as merely an evidence of accountants' desire to make their own work easier. But this is one of the many matters in which the interests of accountants and of the business public are concurrent. Mr. Sloane, speaking for one of the greatest corporations in the world, not only deplores the difficulties arising from the seasonal character of his industry but also indicates the precise nature of the difficulties. When he says that the automotive industry by its seasonal nature leads to "detriment to the wage earner and to national economy," he is speaking of a purely specific condition. He might well have added that concentration of work in a portion of the year is a detriment also to every one who is brought in touch with the industry. While Mr. Sloane believes that attempts to spread the work of the industry over the entire year may be of limited success, it is undoubtedly true that an earnest and consistent effort to avoid unnecessary concentration of work will bear substantial fruit. The automotive industry is one which presents a splendid opportunity for an experiment in the equalization of labor. The natural business year of that industry is probably one that ends with June 30th, and if General Motors Corporation will arrange its financial schedule to close its books at that date the advantages of this change will be manifest to the other great manufacturers and they in turn will probably follow. The automotive industry is doubtless here to stay and it will constitute an increasingly important part in the work of accountants, income-tax authorities and others. There seems to be no reason at all why this industry should not close its books at a time when stocks are lowest; yet few of the large companies have seen the wisdom of adopting their natural year. Now, with the testimony of the head of the largest automobile company in the world to support the movement for the adoption of the natural business year, a little extra effort upon the part of accountants and others should induce the change from an artificial and troublesome calendar-year closing. Every one concerned would benefit by the change and no one would suffer any inconvenience.

**Toward the Perfect
Day**

A few months ago a correspondent sent us information about a scheme which had been promulgated in California for the general amelioration of the condition of mankind and the bringing in of the kingdom of Utopia. It struck us at the time as

an essay in the humor of benevolence. It did not seem then—and does not seem now—as though any ordinarily intelligent citizen of the republic could regard seriously so wild and impracticable a proposition. But lately there has been a coördinated effort in nearly every part of the country to obtain endorsement of this extraordinary plan. It originated in the kindly mind of Dr. F. E. Townsend, who, thinking no doubt of the many unfortunate people whom he had encountered, devised a revolutionary theory which, its proponents are saying, would usher in the dawn of the perfect day. In brief, the scheme calls for a federal pension of \$200 a month to every citizen attaining the age of sixty years, whose record so far as crime is concerned is clear. In return for this comfortable livelihood the recipient is to agree to abstain from all gainful occupation and to spend within the confines of the United States the entire \$200 within thirty days of its receipt. It is estimated on the authority of “statisticians” that the initial cost for the first month of operation would be approximately two billion dollars, which is to be provided by act of congress. Thereafter the expenditure of the two billion of monthly income to the aged will so encourage business and stimulate activity that the thing will become self-supporting. The exact process by which two billion dollars expended in September will so quickly revert to the government as to provide the two billion dollars required for October is not clearly shown. It is said that a sales tax of two per cent. will produce the amount required, but we have yet to find upon what basis this computation rests. It seems to imply an immediate return to the government as a result of a sales tax and thus to establish a sort of revolving fund which will take care of the disbursements of the months as they occur in the march of time.

**Almost Anything
Might Happen**

The arch proponent of the Townsend plan expresses the belief that ninety per cent. of the voters of the country would favor adoption of such a measure. Probably ninety per cent. would approve. Approximately ninety per cent. would not be able to see sufficiently far or clearly to understand the utter disaster which would follow so preposterous an overthrow of the fundamentals of economics. It seems to us that those who advocate and those who support such a plan are setting cheerily out on a road, not clearly defined on either side, but leading, they

blindly trust, over the mountains to that undiscovered land where the cattle always have longer horns. And it has been said of the people of these United States that they are lacking in imagination! If it were not for the extraordinary response which has met this call from fairyland it would still be merely a subject of gracious entertainment. But there is apparently some danger that it may go beyond the realm of idle speculation and find its way into that morass of brainless legislation which takes up so great a part of the time of congress. If ninety per cent. of the voters favor such a plan we may be quite sure that there will be members of congress who will not dare to oppose it. (There have been cases in the history of this country in which legislators have sometimes demonstrated a little less than divine wisdom.) It is even conceivable in the present state of the public mentality that the thing might become a law. Of course it could not be administered, but the impossibility of administration has not always checked the enactment of perfectly futile legislation. We have, however, a supreme faith in the ultimate good sense of the American people, and if by chance or by opaqueness the Townsend measure should become a law it would soon be rescinded. But in the meantime much grievous damage might be wrought.

**The Land of Corn
and Wine**

On the other hand, what glorious vistas are opened before us. Two hundred dollars a month is more than most of us have ever received, and we shall be a little bit confused by our sudden accession of wealth. We are to spend our money promptly, and in order that we may be kept strictly in the narrow path it will be necessary for some child under sixty to follow us around throughout the month and see that we spend. This, of course, will entirely abolish the evils of unemployment. Then, again, if we strike out all sexagenarians, we shall be relieved of the presence in active life of many of the members of congress, quite a host of senators and a vast number of the men who are now directing the affairs of American business, as it is still called. There will be great demand for some of the things which we now regard as luxuries—for example, fine white pine and sharp pocket knives will be urgently needed to occupy the idle time of the aged brethren on the steps of the country store; but they must be careful never to sell or to give away with any thought of ultimate recompense a toy boat or a duck's head in which the whittling

fever may have taken form. Again, we have been disappointed in the revenues derived from the sale of liquor. For two hundred dollars a month, which must be spent, each of us will be able to buy a fair amount of stimulant, even at the present prices. Another blessing will soon appear to all who long for rest or for a pension. Everyone with even a little political influence will be able to set the clock ahead by ten or twenty years and then we shall take up polo and badminton, suitable to the prematurely aged. Of course, some of us, as we reach the end of the world on the sixtieth degree of west longitude, may feel a little regret at leaving behind us all the things for which we have striven, but we shall soon become used to the sweet spaces of do-nothingness, and at last we shall learn to sit and fold our hands and care nothing at all whether the country goes to hell or not, so long as we may remain within the passive realm. There is, however, one speck in the clear blue sky of this Utopia: really \$200 is not very much money, and we do not see why it should not be \$2,000 a month or some greater sum, because, if a mere \$200 for each of us over the hill will bring in the promised day, why not apply the same principle and give us more, to the end that prosperity may the more increase. That, when one comes to think of it, is a rather serious oversight in the drafting of the plan. Let us set no limit upon what the old fellows are to receive. They may learn easily to spend and for every dollar they spend let us think how the rest of the country will advance, and let us be glad proportionately.